IN THE

Supreme Court of the United States

SEPTEMBER TERM, 1958.

No. 299

THE CUBA RAILROAD COMPANY,

Petitioner,

against

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioner prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Second Circuit, affirming the judgment of the United States District Court for the Southern District of New York, in favor of the defendant on a motion for summary judgment.

Opinions Below.

There were five opinions in the District Court (pages 63-68, 87-92, 137-138, 138-143 and 158 of the printed record). Two of these are reported at 124 F. Supp. 182 (1954) and 135 F. Supp. 847 (1955). The opinion of the United

States Court of Appeals for the Second Circuit, a copy of which is printed in Appendix A, is reported at 254 F. 2d 280.

Jurisdiction of this Court.

The original judgment of the District Court was entered February 27, 1957. The decision of the Court of Appeals affirming the judgment of the District Court was dated April 18, 1958. The Court of Appeals denied a petition for rehearing. The final judgment was entered on May 27, 1958.

The jurisdiction of this Court is invoked under 28 U. S. C. A. 1254(1).

Questions Presented.

1. Whether or not the compromise and agreement with respect to various items forming the basis for the execution of Treasury Department Form 870-TS may subsequently be disregarded by the Government?

2. May the Government conduct a second audit of a tax return and refuse to permit a deduction it had previously agreed to in connection with a deficiency assessment paid by taxpayer, and as a result defeat the taxpayer's claim for a refund based on a statutory credit which was not in existence at the time the deficiency was assessed?

Statement.

Petitioner, a New Jersey corporation, which operates a Railroad in Cuba brought suit for refund of tax in the sum of $33,506.83 relating to its fiscal year ended June 30, 1943.

The claim for refund was based upon the payment by petitioner to the Cuban Government in 1950 of Cuban profits and excess profits taxes of $33,506.83 for the fiscal year ended June 30, 1943, as to which payment no foreign

tax credit had ever been claimed by petitioner with respect to United States Government taxes for that year. The Government contends that it has still available to it certain offsetting items with respect to petitioner's 1943 return which preclude the collection of a refund. That is, in 1948 a deficiency of $102,173.39 had been assessed by the Government on petitioner's 1943 return, following which lengthy negotiations took place in an effort to compromise certain disputes as to the proper amount of the deficiency. In 1949 an agreement was reached, the effect of which was that the Government agreed to allow certain bond interest deductions claimed by petitioner, and petitioner agreed to the payment of a portion of the deficiency. This agreement was recorded on Form 870-TS, issued and prepared by the Internal Revenue Service.

The petitioner claimed the refund after paying the Cuban Taxes and after the claim was denied suit was brought.

Before answer, both sides moved for summary judgment. Petitioner's motion was granted and respondent's motion was denied, but respondent was granted leave to plead any setoff it might have against the petitioner.

Respondent in its answer changed its position with respect to the item of bond interest which it had previously conceded, and as a result of the recomputation claimed a setoff in the sum of $51,062.17.

The petitioner moved again for summary judgment claiming that the allowance of the bond interest was proper and that in any event respondent should not be permitted to change its position with respect to the bond interest. The motion was originally granted but on reargument, the motion was denied.

Petitioner filed an amended reply alleging estoppel against the respondent on the ground that if the respondent was permitted to change its position with respect to the

bond interest and was now sustained in its contention that the interest should only have been deducted in the years in which it was paid rather than in 1943, the petitioner would be injured, inasmuch as it could not now amend its returns for the year 1943 through and including 1948, since the Statute of Limitations would bar amendments of the returns relating to said years. Both sides again moved for summary judgment. Petitioner's motion was denied, respondent's motion was granted and judgment was entered for respondent.

Reasons for the Allowance of the Writ.

The decisions below should be reviewed on the grounds that the Circuit Court 1) decided an imporant question of Federal law which has not been, but should be settled by this Court and 2) decided a federal question in a way which conflicts with applicable decisions of this Court.

1. The Circuit Court held that the Government could change its position with respect to the bond interest under the doctrine of *Lewis* v. *Reynolds*, 284 U. S. 281 (1932); *Bull* v. *U. S.*, 295 U. S. 247 (1935) and *Stone* v. *White*, 301 U. S. 533 (1937). The petitioner contended that the controlling case should be the more recent case of *Rothensies* v. *Electric Storage Battery Co.*, 329 U. S. 296 (1946), and that under said case equitable recoupment or setoff should be limited and should only be applied if the claim being sued upon and the subject matter of the so-called setoff originated in the same transaction. Taxpayer contended and repeats its contention that in the instant case, the claim being sued upon and the subject matter of the so-called setoff could not possibly have originated in the same transaction, since it was not until 1950 that the claim for refund

was available to the petitioner. This was more than a year after the execution of Form 870-TS in connection with which respondent had agreed that it was proper for the taxpayer to deduct all of the bond interest in 1943. In addition to the *Rothensies* case, *supra*, the case of *McEachern* v. *Rose*, 302 U. S. 56 (1937) also recognized that for the doctrine of equitable recoupment to be available, there must be "a single taxable event".

2. The final argument made below by the petitioner was that the Government was estopped from changing its position with respect to the bond interest agreed upon in 1949 by acceptance of Form 870-TS and the accompanying payment, since, if it was now permitted to change its position, the taxpayer could not make any deductions of the bond interest, as the time for taxpayer to file amended returns covering the years 1943 through 1948 had expired.

The following language appearing at page 282 of the decision of the Circuit Court appears to be the basis for the Court's decision:

> "On the contrary, when the taxpayer seeks a refund for a credit mistakenly denied, he must be content to allow his tax for the same year to be corrected because of errors through which he has profited."

It is submitted that the above language is inapplicable since it assumes that in the instant case the petitioner is changing its position with respect to the items conceded by respondent and agreed upon by both parties. It must be remembered that in the instant case the taxpayer's return had been audited in 1948 and at that time it was agreed that the deduction of the bond interest was correct. No error is present and repudiation of its agreement by the respondent cannot be designated as error. In its setoff in

the instant case, the respondent in effect has sought to have a second audit of the taxpayer's return. The language from the decision could only be applicable in the event that the taxpayer's return had never been audited by the respondent. In pleading the setoff, which is the equivalent of a second audit, the respondent has in effect conducted "a search of the taxpayer's entire tax history for items to recoup", in direct violation of the language of this Court appearing at page 302 of the *Rothensies* case, *supra*.

3. The questions presented by this petition are of great and recurring significance in the administration of the Internal Revenue Code, inasmuch as the Treasury Department continues to use Form 870-TS or an equivalent in connection with collection of deficiencies in tax and it is submitted that this Court should at this time clarify the confusion existing with respect to the legal effect of said form when executed by the taxpayer.

Conclusion.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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Appendix A.

Opinion of United States Court of Appeals for the Second Circuit.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 217—October Term, 1957.

(Argued March 11, 1958 Decided April 18, 1958.)

Docket No. 24630

CUBA RAILROAD CO.,

Appellant,

v.

UNITED STATES OF AMERICA,

Appellee.

Before:

CLARK, HAND and BRENNAN,
Circuit Judges.

Appeal from a judgment of the District Court for the Southern District of New York, Walsh, J., presiding, summarily dismissing the plaintiff's complaint in an action to recover a refund of part of the payment of its income tax for 1943.

JOHN J. HAYES, for the appellant.

ELLIOT L. HOFFMAN, for the appellee.

HAND, Circuit Judge:

This appeal is from a summary judgment dismissing the plaintiff's claim for a refund of part of its income taxes

for 1943. The action was begun in 1953, based upon the disallowance by the Treasury of a credit asserted by the plaintiff for taxes paid to the Republic of Cuba for the year 1943. The facts were as follows.

The plaintiff, which was on an "accrual" basis as to its U. S. taxes, had issued several series of bonds, bearing interest from five to seven per cent. In 1940 the Republic of Cuba passed a statute limiting corporations doing business in that country to the payment of one per cent interest upon their bonded debts. Various of the plaintiff's bondholders refused to recognize the validity of this law as a defense to their claims for full interest, in 1943 one brought an action in the courts of New York and in which he later recovered the stipulated interest. The plaintiff, finding itself threatened with claims by its bondholders, offered a compromise, called "The Plan," by which it promised to pay two per cent interest in addition to the one per cent allowed by the Cuban law to all bondholders who should deposit their bonds with a designated trustee. Under this "Plan" there fell due in 1943 three per cent on all the outstanding bonds, both then deposited and undeposited. This amounted to $181,000, and the plaintiff claimed the right to deduct that sum as "accrued" interest. To such an allowance the Treasury objected asserting that interest had "accrued" upon only those bonds that had been deposited in 1943. In 1948 the parties entered into a settlement under Treasury Form 870-TS by which the plaintiff's income tax for 1943 included an allowance at three per cent interest for that year upon all bonds that had been deposited under the "Plan" up to 1948, and the plaintiff agreed that no "claim for refund" should "be filed or prosecuted for the year above stated." Form 870-TS contained the clause that the "execution and filing of the offer" was "not, however, a final closing agreement under section 3760 of the Internal Revenue Code." The plaintiff's income tax was liquidated on this basis.

Meanwhile the plaintiff had been negotiating with the Cuban tax authorities and finally came to an agreement with them by which in August 1950 it paid in discharge of

its deficiencies for 1943 the sum of $33,506.33, for which it filed a claim against the Treasury as a credit for 1943. This the Treasury rejected in 1952, and it is subject of the action at bar. The plaintiff justified its delay in filing the claim by virtue of Treasury Ruling 58-55 which makes a foreign tax "accruable" as a credit "for the taxable year to which it relates even though the taxpayer contests the liability therefor and such tax is not paid until a later year." We shall assume without deciding that Form 870-TS, left it open to the plaintiff to recover the claimed refund;* for we hold that the set-off asserted by the Treasury was a valid answer to the claim, and, being larger, is a bar to the action.

It is true that in 1953 the time had passed within which the Treasury could have reassessed the plaintiff's income for 1943; nevertheless, any claim to a refund must be on the theory of money had and received; and, if so, the Treasury was free to show that the interest that had accrued on bonds deposited after 1943 was not a deduction allowable in 1943. Since the plaintiff must repudiate Form 870-TS in order to recover at all, the Treasury is free to treat its allowance of the interest on bonds not deposited in 1943 as a set-off under the doctrine of *Lewis* v. *Reynolds*, 284 U. S. 281, *Bull* v. *United States*, 295 U. S. 247 and *Stone* v. *White*, 301 U. S. 532. To this the plaintiff answers that the decision of the Supreme Court in *Rothensies* v. *Electric Storage Battery Co.*, 329 U. S. 296, limited the doctrine of "equitable set-off" to occasions when the claim for refund and the set-off "originated in the same transaction." In that case the assessed income of the taxpayer had been increased by the sum of the aggregate payments collected from it in earlier years upon a tax, later found to be invalid, and the assessment of this amount as part of its income in the year of its receipt the Court held to be correct. The taxpayer attempted to set-off against this assessment the amounts it had paid in earlier years before the invalid tax had been so declared for which recovery was barred

* *Botany Mills* v. *United States*, 278 U. S. 282; *Longuette* v. *Patterson*, 250 F. 2d 753, 756 (C. A. 5).

by the statute of limitations. This the Court denied, holding that the doctrine of *Lewis* v. *Reynolds*, *supra*, went no further than to permit a transaction which is made the subject of the suit "to be examined in all its aspects" (p. 299).

In the case at bar the claim for refund was based upon the disallowance as a credit to the plaintiff's income tax for 1943 of Cuban taxes which it was later compelled to pay. The set-off is for the deduction unnecessarily allowed upon the plaintiff's income tax for the same year. We do not believe that *Rothensies* v. *Electric Storage Battery Co.*, *supra*, meant to hold, when the refund and the set-off both depend upon what were the proper deductions in the same year, that the transactions which determine those deductions must be so narrowly connected. On the contrary, when the taxpayer seeks a refund for a credit mistakenly denied, he must be content to allow his tax for the same year to be corrected because of errors through which he has profited. It is indeed true, as Jackson, J., said on page 302, that in the "assessment of deficiency" the "claim for refund" does not "invite a search of the taxpayer's entire tax history for items to recoup," but nothing could be more unjust than to allow one party to disregard the settlement and the other to enforce it.

Little need be said in answer to the plaintiff's argument that on the merits it was entitled to a deduction for interest due on the undeposited bonds. The "Plan" of 1942 provided for the payment of interest on the bonds at three per cent only on condition that the bondholders deposited their bonds with the designated trustee. As we have said, during the year 1943 the taxpayer was still contesting the right of its bondholders to any interest above one per cent, except in so far as such a right was granted under the "Plan." That being true, it could claim no deduction except for what became due in that year under the "Plan." Such bondholders as had not deposited then might never do so, yet their right to recover the stipulated three per cent was conditional upon such a deposit; therefore it had not then "accrued." *Dixie Pine Co.* v. *Commissioner*, 320 U. S. 516.

Judgment affirmed.

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v.

UNITED STATES OF AMERICA.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 290

THE CUBA RAILROAD COMPANY, PETITIONER,

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

This case arises out of a suit by the petitioner for a refund of 1943 income taxes in the amount of $33,506.83. (R. 3-5.) The Government first defended on the ground that the suit was barred by a settlement agreement executed in 1949. (R. 33-38.) The district court, holding that the settlement lacked necessary binding formalities, overruled this defense, allowing petitioner to maintain the suit, subject, however, to the Government's right to a set-off for any deficiencies due for petitioner's 1943 income taxes otherwise barred by the statute of limitations. (R. 63-68, 124 F. Supp. 182.) Thereupon the Government filed its answer, including

a set-off in excess of the amount of petitioner's refund claim. (R. 70-74.) On petitioner's challenge by motion for summary judgment (R. 76), the district court again upheld the Government's right to a set-off.[1] Finally, on cross-motions for summary judgment (R. 149, 156), the court held the full amount of the set-off to be good, and entered judgment dismissing the complaint. (R. 158.)

The judgment was affirmed by the court of appeals on April 18, 1958. (Pet. 7-10, R. 161-166, 254 F. 2d 280.) A petition for rehearing (R. 168-173) was denied on May 14, 1958 (R. 174), and on the same day, the clerk of the court of appeals entered an according order. (R. 175.) The petition for a writ of certiorari was filed in this Court on August 22, 1958.

The petition for a writ of certiorari, filed 100 days after the date of the denial of the petition for rehearing, is clearly out of time. Petitioner's reference to a "final judgment" of May 27, 1958 (Pet. 2) is not supported by anything in the transcript of the record certified to this Court by the clerk of the court below,[2] and in any case, the date of the denial of the petition for rehearing is the controlling date. *Gypsy Oil Co.* v. *Escoe*, 275 U.S. 498; *United States* v. *Ellicott*, 223 U.S. 524, 539.

In any event, there is no occasion for further review of the decision below. Petitioner's first contention

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[1] The district court, another judge sitting at this juncture, at first denied the right to a set-off, but on re-argument withdrew this order. (R. 137-143, 135 F. Supp. 847.)

[2] On May 27, 1958, an order on the judgment of the court of appeals was entered in the district court. It is presumably that order of the district court to which petitioner refers.

(Pet. 4-5), that the Government's set-off must be confined to the same transaction as that covered by the refund claim, is plainly erroneous.[3] The rule is settled that a taxpayer's suit for a refund of income taxes for any given year opens to inquiry his entire income tax liability for that year, and the Government's set-off is not confined to the specific item or transaction on which the refund claim is based. *Lewis* v. *Reynolds*, 284 U.S. 281; *United States* v. *Memphis Cotton Oil Co.*, 288 U.S. 62, 70; *Roybark* v. *United States*, 218 F. 2d 164, 165 (C.A. 9th); *United States* v. *Pfister*, 205 F. 2d 538, 541 (C.A. 8th); *Routzahn* v. *Brown*, 95 F. 2d 766, 769 (C.A. 6th); *Thurman* v. *Studebaker Corp.*, 88 F. 2d 984, 987 (C.A. 7th); *Nye* v. *United States*, 84 F. 2d 457, 464 (C.A. 1st). The case of *Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. 296, relied upon by petitioner, is not in point and in no way qualifies the forgoing rule; it simply holds that where *more than one year* is involved, the period of an equitable adjustment for inconsistent taxation of the same transaction will be confined to the tax years involving the one transaction.

Petitioner's second contention (Pet. 5-6), that it may sue for a refund of taxes in disregard of a purported

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[3] The refund claim is based upon an alleged accrual in 1943 of Cuban taxes paid after contest in 1950. (R. 3-5.) The set-off is based upon the erroneous allowance of a deduction for interest in 1943 that was neither accrued nor paid in that year. (Pet. 10.)

settlement agreement but enforce the settlement to bar any set-off against its refund claim, is manifestly without merit.

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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SEPTEMBER, 1958.

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